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국제학석사학위논문

**Analysis of Economic Reform in North
Korea:
Comparison with Chinese Case**

북한의 경제개혁에 관한 분석과 평가:
중국과의 비교를 중심으로

2016 년 8 월

서울대학교 국제대학원
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Master's Thesis

**Analysis of Economic Reform in North
Korea:
Comparison with Chinese Case**

A thesis presented

By

Hyun Ji Ha

To

Graduate Program in International Area Studies

In partial fulfillment of the requirements

For the degree of Master

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Seoul National University**




북한의 경제개혁에 관한 분석과 평가: 중국과의 비교를 중심으로

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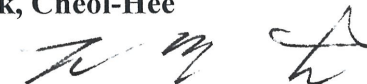
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Abstract

Analysis of Economic Reform in North Korea: Comparison with Chinese Case

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In the 1990s, with the disintegration of the former Soviet Union and the death of Kim Il-sung, North Korean economy entered one of its worst phases. North Korea faced various difficulties resulted from the planned economy. So it has been trying to make its endeavors to escape from economic crisis by reforming its economic system, albeit limitedly, since 2002, including 7.1 economic reform measure, Special Economic Zones (SEZs), and Our Style Economic Management Methods.

Then, is North Korea really adopting comprehensive economic reform since 7.1 Measures in 2002? If so, how far has the reform progressed? Will these changes in the North Korean economy eventually result in opening up like China did in the late 1970s?

This paper aims to answer the questions above. It analyzes and assesses the change of North Korean economic policies and to see how far these economic changes have been progressed since July 1st 2002 by comparing with Chinese

reform in the late 1970s. Therefore, it argues that North Korea is not launching a comprehensive economic reform as China did due to the several reasons.

The North Korea economic policies are very similar to those of Chinese in the late 1970s. However, no one really knows what impact these policies have made in the North Korean society and it is likely that the result of those economic policies will not result in the same level of economic achievements in China. Compared to the Chinese economic reform in agriculture sector, industrial sector and in special economic zones, the prospects of the North Korean reform do not appear encouraging. The private property ownership is still not allowed, the market is still controlled by the government, it is less likely to attract foreign capital to special economic zones with the international isolation and it is impossible to confirm whether the central-government have decentralized authority.

The country's reforms have been limited both in scope and depth. The North Korea regime prefers political stability that it will not pursue any larger scale reforms because economic reform would likely undermine the stability of the regime. In other words, North Korea's primary purpose is not economic development or economic recovery, but is a stabilization of the regime. It is true that the number of markets have been increasing, but North Korea still lacks of

essential elements to launch a comprehensive economic reform as there are too many obstacles to be solved.

Despite the recent economic policies introduced in North Korea over past 10 years, the prospects for the North Korean economy remain clouded due to the internal limits and absence of external cooperation. These obstacles make difficult for North Korea to reach beyond partial measures.

Keywords: North Korea, China, Economic Reform, 7·1 Management Improvement Measures, Our Style Economic Management Methods

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Chapter I. Introduction

1. Research Questions and Background

The purpose of this paper is to know whether North Korea is trying to implement comprehensive economic reform. It analyzes and assesses the change of North Korean economic policies to and see how far these economic changes have been progressed since July 1st 2002 by comparing with Chinese reform in the late 1970s.¹

With the collapse of Soviet Union and the death of Kim Il-Sung, North Korea's society had become unstable and was in the midst of a severe economic crisis in the 1990s as it suffered from a great famine in the mid-1990s. The dominant view during that period about North Korea was that the regime would soon collapse in the foreseeable future. Many politicians, experts and analysts said that South Korea should prepare for the worst scenario.² However, North Korea regime has remained in power for more than two decades. International food aid has helped regime to escape from this great famine, but the North Koreans' living conditions are still very poor.

¹ For convenience, the Democratic People's Republic of Korea will be referred to as "North Korea," and other countries will be called in generally used names such as China and South Korea.

² 이춘근·박상봉. 『북한 급변사태와 한국의 대응』. 서울: 한국경제연구원, 2011. 정한구, 「북한은 붕괴될 것인가」, 『세종정책연구』. 2009년 제 5 권 2 호

To recover from economic crisis, the revitalization of the economy has emerged as the leading slogan of North Korea. “*Gang sung dae guk*,” a strong and prosperous state, was declared in 1998. And North Korea has been introduced series of economic reform policy. The July First measure in 2002 was one of the most representative economic reform policies. Since then, it has initiated a series of pragmatic policies: the establishment of Sinuiju Special Administrative Zone, the Kaesong Industrial Complex and Mt. Kumkang Tourist Zone. Since Kim Jong-un inherited the throne from his father in 2011, North Korea has become more active in pursuing economic reforms. He implemented so called June 28th measure in 2012 and May 30th Measures in 2014.

It is undeniable that North Korea has initiated a round of reform aimed at developing the economy. But there had been a debate over whether Kim would be able to introduce economic changes to the North Korea’s state-planned economy.

Then, is North Korea really adopting comprehensive economic reform since 7.1 Measure in 2002? If so, how far has the reform progressed? Will these changes in the North Korean economy lead to opening up like Chinese case?

By comparing with Chinese economic reform since late 1970s, this thesis evaluate how deep and wide the North Korean economic reform is progressed currently.

2. Literature Review

Nearly 14 years have passed since North Korea started to introduce its economy measures. It is beyond all doubt that the North Korean government should carry out comprehensive economic reform to revive its economy. Economic reform in North Korea is historically inevitable as it is the trend of socialism. And North Korea cannot achieve economic growth without the reform. Successful economic reform will bring many advantages to North Korea, for example reduction of tensions in the Korean peninsula.

There are many different views on economic reform of Kim Jong-il and Kim Jong-un. Some asserts that there are many promising signs that North Korea would pursue the economic reform that it would eventually turn into market economy system. Yoo Wan-Ryung notes that North Korea introduced elements of a market economy system to pursue a policy of “one country, two system”³ like China did. Gong Yutao notes that North Korea is making progress towards a Chinese style of economic reform. Zhang Huizhi asserts that special economic zones in North Korea are the proofs that North Korea is committed to economic reform and North would not be able to stop the marketization. Young-hoon Lee

³ 유완영. “북한의 ‘경제개발구’ 창설계획의 의의 및 전망 - 발표문,” 『정책세미나 자료집』 (서울: 여의도 연구원). 2013.11.13, p.12

argues that North Korea would be forced to open up and embrace economic reform.⁴

On the other hand, doubts remain over the North Korean current economic reform. Zhang Lianggui argues that what North Korea wants to achieve through economic policy change is to support the military-first policy. Change of economic policy is just a way to earn revenue for the military development.⁵ And North Korea's unique political system which is the monolithic Kim dynasty-centered system is the biggest barrier blocking implementation of economic reforms in the country.⁶ It is true that there were numerous changes in the North Korean economy since 2002, however, military sector has not shown much change and government military expenditures have remained stable. This proves that that military continues to be a priority in North Korea, not economic reform.⁷ It was proven by its continuous nuclearization. So if there is any chance that economic change would destabilize the country, the North Korean government would not continue to pursue economic reform.

⁴ Beauchamp-Mustafaga, N. (2012). Prospects for Economic Reform in North Korea. *China Perspectives*, (2012/4), 70-72.

⁵ Ibid.

⁶ Park, Y. S. "The political economy of economic reform in North Korea." *Australian Journal of International Affairs*, 63(4) (2009), 529-549.

⁷ Young-sun Lee and Deok-ryong Yoon. "The structure of North Korea's political economy: changes and effects," *Korea Institute for International Economic Policy*, Vol. 4. No. 3, (2004)

There are so many research on the North Korean's economic reform and many scholars, researchers and reporters have different opinions on prospect of this economic reform. Most of the people agree that the change is happening, however, it is not easy to predict and assess its economic reform. It is because there is limited way to verify whether North Korea is actually enforcing the new economic policy or those changes are just a formality.

3. Limitation

The major obstacle of this research is limited access to North Korea's information. North Korea releases very few economic data that are reliable to outside world. When the North Korean economy began to experience slow growth since the mid-1960s, they started to reduce the reporting official figures. In the absence of economic statistics from the government itself, it is limited to get a reliable data of the North Korean economy.

Also the Trade statistics in china are unreliable as the biggest trading partner of North Korea, China, does not fully release its dealing with North Korea and the trade along the Chinese border, where the most of the trade is conducted, is not recorded by Chinese government.

Foreigners and researchers enter the nation with restrictions and risks, so that they cannot get accurate information from the country. This thesis is based on this limited information availability.

4. Analytical Framework and Research Methodology

This study is a comparative study of China and North Korea's economic reform. To analyze and assess the economic reform, an analysis of the firsthand materials need to be conducted. However, those reliable firsthand materials are hard to access in North Korea. It is almost impossible to find any materials that are reported against the central government's will in North Korea. And the comparative analysis is one of the methods that can overcome this limitation of firsthand materials.

The scope of the North Korean reform is from July 1st measures in 2002 to May 30th Measure and China is from 1978 to 1980s. This dissertation compares the North Korean's agriculture reform, industrial reform and Special Economic Zones (SEZs) with those of China's case.

This paper looks at economic measures that North Korea has adopted since 2002 and assesses the reform. Before comparing with China's case, North Korea's various measures for economic reform in agricultural sector, industrial sector and special economic zone are explained. The time is separated into two periods, which is Kim Jong-il era and Kim Jong-un era.

And the paper compares the reform policies of two countries. China's economic reform has been recognized as the most successful in the world. The reform paths of Chinese economic reform was from agriculture, enterprise and special economic zones. Starting in 1978, Chinese economic reform measures were

introduced and implemented in each of the three sectors. This is why this paper concentrates on the three sector.

It evaluates economic reform using four variables: 1) the extent ownership changes (Privatization), 2) marketization, 3) an open-door policy, and 4) the extent central command is loosening. Applying these variables, the paper analyzes and evaluate economic changes in North Korea.

5. Structure of Thesis

This thesis is composed of 5 parts. Following this instruction, the chapter 2 briefly deals with the transition theories from the experiences of the Soviet Union and China. And it deals with Chinese reform process through three specific areas. Reforms of the agricultural system, industrial sector and special economic zones (SEZs). Chapter 3 deals with the North Korean's new economic reforms. It examined North Korea's various measures for economic reform by dividing them into 2 periods: Kim Jong-il and Kim Jong-un era. And each regime's policy on agriculture sector, industrial sector and the special economic zones are introduced in this chapter. In Chapter 4, the North Korean economic reform is evaluated by comparing with the Chinese style. Lastly, Chapter 5 will explain the obstacles that to reform and opening to explain why the result of economic reform in North Korea and China is too difference when the policies are very similar. Conclusion (chapter 6) will summarize all the findings of this research.

Chapter II. Two types of Socialist Reform

1. Transition strategies

Socialist states took different routes of transition from communism. Transition means the process of change from a centrally planned economy towards market-oriented economy to solve social and economic problems in former socialist countries. There are two main conflicting transition strategies, radicalism and gradualism. Some nations had implemented a different route of reform that cannot be categorized either of them. However, only few of them are in this unique track and majority of the states could be recognized as either radicalism or gradualism. These two strategies have different way of achieving market-oriented economy.

1.1 Radicalism

Radicalism, also called “shock therapy” or “big bang”, emphasized the speed of the reform. Everything should be done as quickly as possible including macroeconomic stabilization, price and trade liberalization and privatization of state owned enterprises.⁸ The Russia economic reform of 1992 and later years is

⁸ Martin Myant And Jan Drahokoupil, “Transition Economies: Political Economy in Russia, Eastern Europe, and Central Asia,” *John Wiley and Sons* (2011)

regarded as this route and it was supported by Western consultants of IMF, World Bank and EBRD⁹.

According to Woo, four actions implemented simultaneously in the radicalism.

“(1) Almost complete price liberalization... (2) Liberalization of the trade sector by a currency devaluation to the black market level and removal of trade barriers. (3) Adoption of noninflationary macroeconomic policies. The budget deficit is reduced, the primary method being cutting subsidies to the SOEs... (4) Legalization of private economic activities, decentralization of production and investment decisions, and announcement of impending privatization of SOEs.”¹⁰

Lipton and Sachs argue that speed is the most important reform element in transition and emphasized the importance of rapid stabilization and the immediate liberalization of price and international trade and finance.¹¹ Moreover, radicalists believes that radicalism-based liberalization policies and macroeconomic stabilization measured would involve the lowest risk.¹²

⁹ 박형중, 「사회주의 경제의 체제전환전략: 급진론과 진화론」, 『통일연구논총』 6(1) (1992 년 7 월), p.222

¹⁰ Woo, Wing Thye, “The act of reforming centrally planned economics: comparing China, Poland and Russia,” *Journal of Comparative Economics*, Vol. 18, (February 1994), p. 277.

¹¹ Lipton, David and Jeffrey D. Sachs, “Creating a market economy in Eastern Europe: the case of Poland”, *Brookings Papers on Economic Activity*, 21:1 (1990), pp. 99-111.

¹² Iwasaki, I., & Suzuki, T. “Radicalism versus gradualism: A systematic review of the transition strategy debate” *Russian Research Center, Institute of Economic Research, Hitotsubashi University* (No. 45, 2014), p. 12

The former Soviet Unions, particularly Russia, have tried to make the transition to a market economy and Russian economy has experienced dramatic reform since 1992 when Russian president Boris Yeltsin succeeded Mikhail Gorbachev as Russia's president. Yeltsin and his major advisors clearly felt that the reforms should be as comprehensive as possible and enacted in as short time as possible, which refers to shock therapy – full price liberalization, and free, privatization of state-owned enterprises and assets. However, the economy did not get any better with those policies.

1.2 Gradualism

Gradualism is the opposite concept of radicalism and it is the Chinese and Vietnamese models of economic reform. This route received attention with two reasons: 1) the strategic performances of the radicalism-based reform of Eastern Europe was not as satisfied as it was expected, 2) China's economic growth was far better than Eastern Europe countries.¹³

Gradualist-based reform is a slow-paced reform strategy. Gradualists believe that it is impossible and undesirable to breakdown communism economy's system all at once. When the radical approach emphasizes destruction of old institutions, gradualism approach asserts to continue to operate existing institutions. They believe that rapid change in existing system would destroy

¹³ 박형중, 「사회주의 경제의 체제전환 전략: 급진론과 진화론」, 『통일연구논총』 6(1) (1992 년 7 월), p.224

much of the system and rapid breakdown of the old system would cause economic collapse. Economic players had been developing under the old system and they need time to adjust to the change. Although the old system might not be useful in the long run, it could still operate in the beginning stages of reform. After a certain period when the new private sector institutions grow, the old system could be gradually replaced.¹⁴

China's reforms began in 1978 in experiment and gradual manner. It took economic reform under the strong direction of its Communist Party unlike Russia. Leaders of China felt that communist dictatorship and market economy can be compatible and they needed to move slowly.

To support this theory, gradualists frequently compare China and Russia. The result of the reform was that China has achieved a remarkable economic growth while Russia failed. For example, Russia's production fell, gross domestic product (GDP) decreased by 40% and real income had decreased by 26% in the period of 1992-1996.¹⁵ However, China has enjoyed more than 3 decades of the greatest economic growth. Blanchard and Kremer said on their paper that China could avoid the collapse during the reform because of low degree of

¹⁴ Peter Murrell, "Evolutionary and Radical Approaches to Economic Reform," *Economic of Planning*, Vol. 25, Issue 1, (January 1992), p. 88

¹⁵ Kazakevitch, G., & Smyth, R, "Gradualism versus shock therapy:(Re) Interpreting the Chinese and Russian experiences," *Asia Pacific Business Review*, 11(1) (2005), pp. 71-72

industrialization, maintenance of the power of Communist Party, decentralized system and its gradual pace of economic reform.¹⁶

2. Economic Transition in the Soviet Union and China

It is widely acknowledged that China has been more successful than the Soviet Union transition from a planned socialist economy to market economy system. Gorbachev's reform was not as radical as that of Yeltsin's before the Soviet Union collapsed, however, it still failed to achieve an impressive economic growth like China. This phenomena raised an important question: why has the transition that occurred in the socialist countries have different outcomes? In particular, why did the two largest communist states, China and the Soviet Union, showed different transition outcomes? These questions are very important in the study of the North Korea's economic reform as predicting regime change is based on the understanding of the past.

2.1 Initial Conditions

The initial conditions was very different and it influenced the outcome of the reform. China had more favorable initial conditions than Soviet Union.

In the 1970s, China was underdeveloped and overwhelmingly agricultural. The composition of the labor between the two countries were different. About 70% of the Chinese worked in the primary sector of industry (agriculture, fishery

¹⁶ Blanchard, Oliver and Michael Kremer, "Disorganization," *Quarterly Journal of Economics*, 112:3, p. 1122

and forestry). China had a small and uncompetitive industrial base. It struggled with the problem of excess population relative to the available land, resulting in the availability of cheap labor. The GDP per capita was only \$150, while it was \$3,427 in Russia in the beginning of the transition. Deng's policy was to transfer agricultural people to modern industrial sectors and he expected that this would eventually bring up the rise of the nation's productivity and a growth in GDP.

On the contrary, the Soviet Union's initial condition was very different. Most of the labor force was employed in non-agricultural state enterprises. By the late 1980s, the Soviet Union was a military superpower competing with the United States and it was a mature industrial economy with an educated labor force. Russia's agriculture was heavily centralized. It struggled with the problem of declining of population. Gorbachev tried to raise the productivity in the secondary sectors where the labors were already overwhelming. And as those sectors were already entwined with vested interests, it could not be easily achieved.¹⁷

In China, power was relatively decentralized economically, but politically centralized, whereas the power was centralized in ministry managers in the Soviet Union. Centralized control over the economy prevented the country from innovation.

¹⁷ Tabata, S, *Eurasia's Regional Powers Compared—China, India, Russia*, (Routledge: 2014)

China is ethnically homogenous that more than 90% of the population is Han Chinese while the Soviet Union was ethnically diverse. So China could use of nationalism as a governing ideology and this strategy is very effective in countries where people share a common identity. However, in the Soviet Union, the collapse of the empire was facilitated by diverse ethnic.

China had a large Diaspora located near China such as Hong Kong, Macao and Taiwan. And a large number of Chinese were in other countries like Southeast Asia, and North America. They invested in China and contributed financial and human capital. China designated special economic zone in the regions near those places and the success of these zones helped China's reform more successful. China also got invest from Japan and the United States. The competition between US and USSR was so intense that a stronger China was in the interest of the capitalist countries. So China could successfully attract foreign capital. However, the Soviet Union lacked a Russia Diaspora. Not many Russians had immigrated to other countries like that of China and its relationship with the US was not friendly that it could not get international support like China. Therefore, it failed to attract foreign direct investment.

2.2 Economic Reform Failure in the Soviet Union

According to Thomas Bernstein, the reasons that could explain the failure of the Soviet Union's economic reform could be summarized into five reasons: 1. Disunity among the top leaders; 2. Bureaucratic obstruction of economic reform; 3. Poor designed managed reform; 4. the overwhelming problem of downsizing

the military-industrial complex; and 5. the deleterious consequences of political liberalization which Gorbachev had seen as the answer to obstruction.”¹⁸

When Deng came to power, China was seriously damaged by the Cultural Revolution that the Communist Party of China was busy rebuilding the society. This situation afforded Deng the opportunity to embark the economic reforms. Even though there was conflict between conservatives and reformers in the 1980s, the problem was not as serious as that of Soviet Union’s. Deng did not have to fight for consolidating his authority like Gorbachev and he could pursue economic reform without power struggle among elites.

However, when Gorbachev came to power, he was faced with party and government administration that was still dominated by Stalin generation of old officials. The Soviet officials had been interrupting economic reform. So he had to struggle when consolidating his political authority. Unlike Deng, he could not do it so quickly that it was hard for the Soviet leaders to reach a consensus over economic issues. In short, Gorbachev lacked the authority like Deng had.

Second, reform policies were interrupted by the officials in the Soviet Union. Verbally, officials promised to implement reform policies but in reality, policies were only partially carry out or ignored by the officials. All the new systems that were to encourage the development of economy were rejected by the

¹⁸ Bernstein, Thomas, “Economic and Political Reform in China and the Former Soviet Union,” *Center for the Study of Democracy*, (2009), p. 7

nomenklatura as the officials refused to share their prerogatives with production associations and enterprises.

Third, the Soviet Union's reforms were badly designed. Contradictory directive in 1986 was one of the examples. One side wanted to crack down on unearned income from individual labor outside the state sector, while the other side requested for allowing it. This intensified that the Soviet Union's reforms were not ready to be implemented as even high ranking executives could not reach an agreement.

Lastly, Gorbachev believed that in order to solve the economic problem and to make a progress of economic reform, the country needed to reduce military budget and shift resources to the civilian sector. So he took political reform in 1987 and it caused serious problems. The public opinion started to rise and the media started to criticize the government. Moreover, reduction on the military budget created conflict between reformers and conservatives as it required the fundamental reorientation of Soviet foreign policy. However, Deng Xiaoping did not face this kind of problem. He successfully persuaded the PLA leadership to accept decreasing budgets on military and put economic development on the top priority of the country.

3. China's Economic Reforms

China's economic reform has been recognized as the most successful in the world. The reform paths of Chinese economic reform was from agriculture, enterprise and special economic zones. China decided to open its economy at the

3rd plenary session of the 11th Central Committee of the Communist party held in November 1978. Starting in 1978, Chinese economic reform measures were introduced and implemented in each of the three sectors.

3.1 Reform in Agricultural sector

China started its reforms with the agricultural sector. Significant changes in agricultural sector were the emergence of the “household responsibility system” and abolishment of collective agricultures. Xiaogang village was the first in China to implement this new system. 20 peasants gathered together in Xiaogang village, Fengyang Country, Anhui Province in 1978 and signed a pledge. The cadres secretly leased the lands to families, allowed peasants to produce by household to fulfill government’s quota and the exceeded output can be disposed by peasants. This new system increased the agricultural productivity and this system was spread to almost of the agricultural sector in 1982.

Under this system, once households reached the targets set by the state, they were given the rights to use the land and limited management autonomy. Household were not allowed to own the land, but they were granted 15 years leases in 1984.¹⁹

Implementation of agricultural reform improved agricultural productivity and increased the income of farmers. China’s total grain output increase from 304.8

¹⁹ 조영남. 『개혁과 개방: 덩샤오핑 시대의 중국 I』 (서울: 민음사, 2016 출판예정), p.64

million tons in 1978 to 512.3 million tons in 1998. The income of households has increased. Average per capital annual incomes of rural households increased from 133.6 yuan per year in 1978 to 2,162 yuan in 1998, nearly 16 times.²⁰ These successful results helped Deng to intensify and broaden the reform program to other sector.

3.2 Open-door Policy

When the agricultural reform was under way, the government extended economic reform to other sectors. The development of Special Economic Zones (SEZs) were through several stages. In 1980, four southern coastal cities were designated as SEZs, Shantou, Shenzhen, Xiamen, and Zhuhai. Shenzhen shares the border with Hong Kong, Zhuhai is located opposite to Macao, Xiamen is close to Taiwan and Shantou is located on the coast of norther Guangdong. And they were located far away from China's political and economic centers. Their location was aimed at attracting foreign capital and importing foreign advance technology. Some capitalist market factors were introduced including laws, regulations, taxation, land, labor, and finance, etc. The law guarantee to protect foreign enterprises' assets and property. And foreign investors can enjoy a reduced rate of corporate income tax and investors can obtain the rights for land development, use and business. Moreover, foreign invested firms have rights to hire and fire employees.

²⁰ 조영남. 2016. p.68

Following the successful development of the 4 SEZs, in 1984, the central government gradually expanded the SEZs to 14 other coastal cities. From 1985 to 1988, more municipalities along the coastal area were included. More and more cities were opened and as a result, it was gradually expanded to the inland cities.

SEZs has been made rapid progress and produced a boom in China's international trade and economic growth. They have contributed significantly to growth of GDP, import and export, and attraction of FDIs.

3.3 Reform in Industrial sector

The reform was taken in industrial sector as well. The aim of the reform was to reduce the power exercised by the government over state-owned enterprises (SOEs). According to Young Nam, Cho,²¹ reform on SOEs can be divided into three periods. In the period of 1978-1984, large state-owned enterprises (SOEs), located mainly in cities, were granted limited autonomy. In 1978, the Sichuan provincial government selected six state-owned enterprises and undertook an experiment. The government granted expanded decision making autonomy to those enterprises. Once the enterprises meet the target, they did not have to submit all profits to the state, instead they were allowed to keep a proportion of profits. Following on Sichuan's SOE's experiment, the central government selected a group of enterprises nationwide to implement expanded autonomy. In

²¹ 조영남. 2016. p. 99

July 1979, five documents on expanded enterprise autonomy was officially released to encourage local governments to implement similar policies in other SOEs. By the end of 1979, 1,400 enterprises were selected for this and in 1980, the experiment expanded to 6,000 SOEs.²²

In the second stage, from 1985 to 1991, the ownership and management was separated by the “contract responsibility system”. Under this system, managers and directors were given the power to manage enterprises by contract. In the contract, the responsibilities and benefits between the state and the managers were stipulated. Enterprises are required to pay a set amount of profits to the government, but they can dispose above the contract requirement. And the employees get bonuses in accordance with the performance of their work. It increased productivity and profitability. In the third stage, after 1992, ‘socialist market economy with Chinese characteristics’ was established.

Another significant change of the enterprises’ reform in China is that the government allowed the development of private business and private enterprises. Thousands of the unemployed could not find a job and SOEs and collective firms could not hire them all. In this situation, the government could not help but to allow private business and private enterprises. The township and village enterprises (TVEs) were one of the successful examples of the private enterprises and they took root in rural areas. They have been the catalyst of China’s

²² 조영남. 2016. pp. 94-95

economic growth. The private businesses were permitted in 1984 and private enterprises were permitted in 1987.

Chapter III. Economic Reform in North Korea

North Korea had undergone an unprecedented economic crisis for more than a decade during the 1990s. The severe food shortage resulted in the deaths of approximately 2 to 3 million people.²³ In order to escape from this economic crisis, economic reform was absolutely necessary for the North Korean government. The government introduced several economic reforms since 2002.

1. Economic Reform under Kim Jong-il Regime

North Korea has been maintain the Stalinist totalitarian political system for a long term. The fact that China has been achieving impressive economic growth without political reform was a very good news to the North Korean government. So it is more likely that North Korea would follow the path of Chinese reform rather than the Soviet Union Style. Kim Jong-il visited Pudong New Area in 2001 and was very impressed by the China's economic development that he instructed North Korean government officials to study the Chinese experience.

On July 1st, local meetings were convened across the country to announce the new economic measures that would effect immediately which is called the July 1 Economic Management Improvement Measures (*Kyungje Kwalli Kaeson Jochi*, hereafter the July 1st Measure). North Korea government avoided using the word

²³ “[이용종의 바로보는 북한]”식량자급이 수소탄 잇단 캠페인...’대기근’ 빨간불 켜졌다,” 중앙일보, 2016.06.21. <http://news.joings.com> (Access Date: 2016.6.22)

‘reforms’ to describe this new measures because they believe that this term could imply that the original economic system had something wrong. This measure included a number of capitalist elements. It brought realistic wages and prices, relocated the exchange rate, reduced food distribution system, and expanded the autonomy of collective farms and enterprises. Also the government set up Special Economic Zones and enacted a bank law for foreign investment.

In this chapter, it deals with North Korea’s reform in agricultural sector, industrial sector and establishment of Special Economic Zones under Kim Jong-il regime.

1.1 Reform in Agricultural Sector

Before the July 1 measures, cooperative and state farms were in charge of selling the produced crops to the government. Most farms were collectives and each was assigned a quota of farm products and any surplus was managed by the collective farm. The state was supposed to provide seeds, fertilizers, and machinery to farmers and it told the farms what crops to grow.

The Public Distribution System (PDS) distributed food at a nominal cost to consumers and the workers receive food and other basic necessities from the collective farms. In this system, people who had political connections received more than their share, but others with no connections received a very few amount of rations. With the economic crisis, the government’s ration system could no longer provide rations to the consumers.

The reforms in the agricultural sector were implemented after the July 1st measures. Below table contains the major aspects of the agricultural reforms during the Kim Jong-il era.

Reform in Agricultural Sector under Kim Jong-il regime

| Category | Measures | Major Aspects |
|------------------|---|--|
| Grain Production | Improving Cooperative Farm Production Unit System | <ul style="list-style-type: none"> - Expand Family unit (2-5 households) sub-work team organization - In some regions, farm lands were distributed to sub-work team on a trial basis |
| | Strengthen performance distribution | - Conduct performance evaluation by sub-teams (10-25), not by the group (80-120) |
| | Expand right to select grain | - Expand rights of farmers to select their cultivatable grains except rice |
| | Impose rental fee of land | - Categorize land into 3 groups; cooperative farm land, plots owned by institutions and business, privately cultivated land and impose different levies on 3 different groups (lowest 53 jeon to 63 jeon) |
| | Expand privately cultivated Land | - Expand the limit of privately cultivatable land from 30-50 pyeong to 400 pyeong |
| | Trial of private farm system | - Private farm system is conducted on a trial basis in some regions like Hweoryung, Moosan . |
| Grain Purchase | Abolish double grain price system | - Previously, the government purchased the grain in high price (rice: 82 jun/kg) and supplied them in lower price(rice: 8jun/kg) |

| | | |
|--------------------|---|--|
| | | <ul style="list-style-type: none"> - increase price of grains: purchase in 40 won and impose transportation cost, supply in higher price (44won) |
| | Reduce amount delivered to government | <ul style="list-style-type: none"> - The farmers need to deliver 70-80% of production to the government. But It was decreased to 50-60% - cooperative farms have rights to dispose their left grains |
| Grain Distribution | Abolishment of the Public Distribution System | <ul style="list-style-type: none"> - Public Distribution system is abolished - Previously, food was supplied almost free of charge (rice: 8jun/kg) at 1/10 of purchase rice (rice: 82 jun/kg) |
| | Reduce eligibility for provisions | <ul style="list-style-type: none"> - Previously the state provides standard amount (700g) to those who defended the regime and provided 300g to civilian - Since March 2004, the state reduced institutions and corporations that are eligible for provisions and strengthen self-reliance |

Source: Kim, Young Yoon, Choi, Soo Young, Trends in North Korean Economic Reform (Seoul: Korea Institute for National Unification, March 2005), p.47

These reforms in the agricultural sector was implemented after the July 1st measures. North Korea amended its ‘Agriculture Laws’ in June 2002. The most important reason that the North Korean government adopted agricultural reform was to enhance its agricultural production by improving the inefficiencies of cooperative farming. Those reforms eased collectivism and encouraged farmers’ will to work. And it expanded the agricultural autonomy for collective farms.

North Korea rationalized the price of agricultural products. They raised the purchase and selling prices in accordance with the July 1st measures. In the past, North Korea had raised the selling price of rice from 8 jeon/kg to 44 won/kg and raised the purchase price of rice from 82 jeon/kg to 40 won/kg. And price of other grains such as maize, beans and flour were raised as well. There was no significant difference in prices for citizens who wanted to buy grains from either the government or the farmers' market. Raising the price of the grains led to an increase in income for farmers, so it inspired farmers to work hard and improved their living conditions as well as helped them to create a better agricultural environment to boost productions. In addition, by abolishing the double price system²⁴, North Korea tried to decrease financial burdens.

The Price of Rice and Mize of North Korea

| Category | | Before Increase | After Increase | Increase Rate |
|-----------------|------------------|------------------------|-----------------------|----------------------|
| Rice | Purchasing Price | 82 jeon/kg | 40 won/kg | 50 times |
| | Selling Price | 8 jeon/kg | 44 won/kg | 550 times |
| Maize | Purchasing Price | 60 jeon/kg | 20 won/kg | 33 times |
| | Selling Price | 6 jeon/kg | 24 won/kg | 400 times |
| Beans | Selling Price | 8 jeon/kg | 40 won/kg | 500 times |
| Flour | Selling Price | 6 jeon/kg | 24 won/kg | 400 times |

Source: Recited from 2002 년 11 월 북한현지 방문 조사 및 방북자 면접 조사. 고려대학교 기초학문연구팀. 2005. 『7.1 조치와 북한』 (서울: 높이깊이), p.18

²⁴ In the double price system, the state purchased the grain in high-price and supplied them in low prices.

This measure was significant due to the increasing role of the market in North Korea society. Unofficial economic activity led by the farmers' market started to grow in the 1990s and as the PDS was no longer work, North Korean people procured food and necessary supplies from this markets. The government recognized this situation and since 2003, North Korea reorganized the former farmers' market into a comprehensive market. Many agricultural and manufactured products that were not allowed to sell in the farmers' markets in the past started to be traded legally in the new markets. However, these comprehensive markets were one of the state-owned enterprises and managed by a state-run business and needed to pay taxes to the government according to the profits.

The government expanded the "Sub-work team Management System." The new system reduced its members from 10-25 persons into 7 to 8 persons. In some areas, it was reduced to 4-5 persons.²⁵ In 2004, North Korea decided to initiate a trial run of the family farming system. In Soosan of Hwanghae Bukdo province and Hweoryung of Hamgyun Bukdo province, sub-work teams, consist of 2-5 households, were given land by the state to cultivate. The government expanded the rights of farmers to manage their land at their own discretion by giving them right to cultivate a piece of land while the government actually owns the land itself.

²⁵ 최수영, 「7.1 조치 이후 북한의 농업개혁과 과제」, 『통일연구원 연구총서』 (2006 년), p.10

In the past, 70-80% of the production had to be delivered to the government, but only 50-60% of the production needed to deliver. The farmers were free to dispose their exceeded production after paying rental fee of land, materials for productions and military provisions.²⁶

The sub-work team units received provisions according to production performance that the provisions among sub-work team were significantly different. The government no longer distributed provisions by task groups (80-120 persons), but by sub-work team basis (10-25 persons). By changing performance assessing method, it encouraged farmers to compete with each other.

Due to the reforms, farmers' incomes and living conditions had increased. The North Korean government's intention was to enhance the efficiency of the planned economy under new sub-work team management system. However, the target production amount was still very high and the farm did not have enough equipment to cultivate so it was impossible to improve the yield of the crop even under this new system.

1.2 Reform in Industrial sector

After the July 1st measure, limited autonomy was granted to State Owned Enterprises (SOEs). By increasing autonomy, managers would be more conscientious about the whole production and more motivated to improve the

²⁶ 김영훈·권태진·임수경, 「북한의 농업부문 개혁조치 분석과 전망 (1996~2012)」, 『한국농촌경제연구원』, (2013 년) p.45

factories' performance. The party secretary's role over SEOs was reduced while the managers started to have more power. But it does not mean that all of the powers were transferred to SOEs.

The management style had transformed from the production-centered one to profit-centered one. Companies and factories have more independence on issue like investment and production. The Cabinet State Planning Commission plans only major economic indexes that are strategically important, while letting each local governments and companies create detailed plans. Prices and standards for goods are determined by each factories' managers under the monitoring of higher authorities.

An Independent accounting system (*Tongnip Ch'aesanje*) was emphasized. It aims to increase the discretionary power of managers. Managers were allowed to keep surplus revenues and distribute the profits to workers and they were given more discretion in decisions about labor, equipment, materials, and funds. The government allowed firms to plan, produce and sell at least a portion of production at the price set by themselves. Under this system, the workers' wages were distributed according to each worker's contribution. Each work team and group's work is recorded and bonuses were given to those work units who used the raw materials and equipment more efficiently. The managers were also free to buy spare parts and raw materials at market prices within the market economy and sell their products legally at the markets after they meet the demand of the central government. They could trade their production and materials between themselves in a market, named "Socialist Goods Trading Market." In the past,

the state had provided materials and raw materials to the factories and enterprises, but after July 1st measures, the factories and enterprises could purchase lacking materials from this market.

Another important aspect of the July 1st measure was the introduction of a new enterprises' assessment system, which was called the "earned income index (*Beonsuib Jibpyo*).” Earned income is the sum of the net income and the wage of the firms. Previously, the basic criterion for enterprise performance was the ability to achieve the goals of the plan, regardless of sales. But the earned income index assesses the value of a firm on its sales. This system would eventually improve efficiency and profitability of the firm. The earned income index directly relates the interests of managers and the employees as the managers and employees' salaries and incentives would be depend on production.

The enterprises and factories started to be responsible for their own profit and loss. They no longer received any subsidies from the state anymore. These policies motivated managers and workers and high motivation improved the efficiency in the factories.

1.3 Open-Door Policy

The foreign trade and investment are necessary to revive the economy and creating 'Special Economic Zones (SEZ)' was a way to attract foreign capital. Although North Korean leaders were reluctant to take an economic reform, China's experimentation of SEZs had a great impact on North Korea's decision on creating SEZ.

North Korea had already started opening up economically during Kim Il-Sung regime with the establishment of the Rajin-Sonbong Special Economic zone (SEZ) in 1991, but it had failed to achieve its goal.

The Kim Jong-il regime looked for a way to attract foreign capital and established several SEZs. The international atmosphere shaped by the ‘Sunshine Policy’ and improvement of relations with international world set up a favorable environment for North Korea to expand SEZs. This took the form of the Sinuiju Special Administrative Region (SAR), the Mt. Kumkang Tourist Zone, and the Kaesong Industrial Complex (KIC).

1.3.1 Sinuiju International Economic Zone

Sinuiju was first labeled as a Special Administrative Zone in September 2002 on the border with China to attract foreign capital. It was modelled after Hong Kong, Chinese Special Economic zones and planned to develop into a comprehensive economic zone. To attract foreign investors, North Korea adopted the ‘Basic Law (*Kibonpop*).’ For the next 50 years, Sinuiju would be given its own independent authority as it would have its own executive, legislative, and judicial system like Hong Kong. And most importantly, the city’s top executive would be a foreigner. The North Korean central government could not interfere in this place except for diplomacy and national defense matter. Also the city had authority to issue visa independently. Sinuiju was more focused on light industry since then, and the plan was to develop this city as an international finance, trade, commerce, science, entertainment city.

North Korea chose a Chinese-Dutch businessman named Yang Bin to manage the Zone. It was a result of the investment of his to the city that made him become the governor of Sinuiju. However, the Chinese side did not like the idea of locating a SEZ close to China as China did not want the Sinuiju to take foreign capital away from Northeast side of China. Accordingly, Yang Bin was arrested by Chinese authorities on charge of corruption and sentenced 18 years in jail. Sinuiju was finally languished.

1.3.2 Mt. Kumkang

In the far southeast corner of the country along the border with South Korea, Mt. Kumkang zone was established. It was opened to foreign tourists. Since 2004, South Korean could travel to Kumkang by bus across the Demilitarized zone, and from 2008, visitors were allowed to drive their own car for 4-hour for a fee of \$330.²⁷ By the end of 2007, over 1.7 million tourists, mostly South Korean had visited the Mountain and North Korean could earn over \$1 billion from this zone.

However, in July 2008, one of a South Korean females was shot by a North Korean soldier. South Korea asked for a joint investigation but the demand was refused by the North Korean government. This tragic incident caused the shutdown of the tour and since then, this zone is no longer operated.

²⁷ Hassig, Ralph, and Kongdan Oh, *The hidden people of North Korea: Everyday life in the hermit kingdom*. (Rowman & Littlefield, 2009), p.84

1.3.3 Kaesong Industrial Complex (KIC)

Kaesong Industrial Complex (KIC) was formed in 2002, collaborating economic development with South Korea. This city is located 70 kilometers southwest of Seoul and only 5 kilometers away from the DMZ. It is very close to the market and resources of South Korea. After the inter-Korean summit of 2000, Hyundai received permission from the North Korean government to lease a 66 square kilometer zone outside the city of Kaesong.

This industrial section was planned to be developed gradually in three stages.

Size of Kaesong Industrial Complex and Its Benefits

| | Surface area (10,000 Pyong) | Number of Companies | Number of Employees | Output per Annum (million dollars) |
|--|-----------------------------------|------------------------|------------------------|---|
| 1st Industrial Complex | 100 | 150 | 20,000 | 2,000 |
| 2nd Industrial Complex | 300 | 450 | 60,000 | 6,000 |
| 3rd Industrial Complex | 400 | 600 | 80,000 | 12,000 |
| Total | 800 | 1,200 | 160,000 | 20,000 |

Source: Hyundai Asan Corporation, *Investment Environment in Kaesong Economic Free Zone*, November 2000, pp.4-5

When three stages were completed, a total of 1,200 companies would have been operating in this area, employing as many as 160,000 employees and producing 20,000 million dollars of goods annually.

Certain laws and regulations were agreed upon in 2002, but the zone still remained under North Korean jurisdictions. Hyundai Asan had right for using lands for 50 years and this land was established as a duty-free zone. The enterprises' were given rights to hire and fire employees and the right to hire South Koreans and foreigners. There would be no restrictions on the use of communications and IT. North Korean workers receive \$65 per month. But South Korean employer do not pay directly to the North Korean workers. Instead the hard currency is paid to the North Korean local authorities and they would pay to the workers in North Korean won or in daily necessities.

Before the zone was shut down, more than 120 South Korean companies had operated in the KIC from industries including clothing and textiles, car parts and semiconductor. Many of North Koreans were employed and they provided an important stream of hard currency to the country. Kaesong industrial complex project had a socio-political significance and economic significance.

However, this zone was closed down since 2016 following North Korea's rocket launch and nuclear test. If the project had developed as planned and still remained open, North Korea would have earned the international credibility and successfully attracted foreign investment.

2. Economic Reform under Kim Jong-un Regime

Since Kim Jong-un inherited the throne from his father in 2011, he has emphasized on economic development. He went to school in Swiss and fluent in several European languages including English, French, German and Italian. His education background and language ability made others to think that he might be the one who could guide North Korea on a path of reform.²⁸ He promised on 15th April, 2012 that the North Korean people would never have to tighten their belt again.²⁹ It does not mean that North Korea would shift its economic system.

He showed a special interest in economic development. In his New Year's address in 2016, he emphasized the 'economy' rather than *Songun*(military-first). He mentioned *Songun* every year, but as years went by, it was mentioned less and less. For example, it was mentioned 17 times in 2012, 6 times in 2013, 3 times in 2014, 4 times in 2015 and only 2 times in 2016.³⁰

North Korea took the measures of "Our Style Economic Management Methods." It includes 6.28 Economic Reform Measures (hereafter 6.28 measures) and 5.30

²⁸ 정성장, 「김정은 후계체계의 공식화와 북한 권력체계 변화」, 『북한연구학회보』 14 권 2 호, 2010 년, p175

²⁹ "North Korean Leader Stresses Need for Strong Military," The *New York Times*, April 15, 2012, <http://www.nytimes.com/2012/04/16/world/asia/kim-jong-un-north-korean-leader-talks-of-military-superiority-in-first-public-speech.html>, (Access Date: 2016.04.20)

³⁰ "北 김정은 신년사키워드 분석해 보니..."경제에 초점" (종합)" 연합뉴스. 2016.01.03, <http://www.yonhapnews.co.kr> (Access Date: 2016.4.29)

Measures. Agricultural, industrial reforms and special development zones are introduced.

The North Korean's official mass media does not report about the progress of the reform. The information about the reform is reported through a pro-North Korean newspaper in Japan, called *Chosun Sinbo* and South Korea's mass media. According to *Chosun Sinbo*, the reforms have been implemented in some areas on a trial basis and North Korea began to strengthen its economic reform measures by enhancing autonomy in factories and enterprises.

2.1 Reform in Agricultural Sector

The first steps to reform was introduced in 2012, so called the "June 28 New Economic Management Measures," and "May 30th Measures" was introduced in 2014 by the North Korean cabinet of Ministers and the Central Committee of North Korean Workers' Party. These new measures aimed at boosting production by creating incentives for farmers.

| | June 28 th Measures | May 30 th Measures |
|------------------------------|--|---|
| Size of sub-work team | - The sub-work teams are reduced from 15 to smaller groups of 4-6 people | |
| Land | - Sub-work teams are given a plot of land for several consecutive years - The land technically remained under the | - Production teams are given large plots of land 3,300 m ² |

| | | |
|---------------------|--|---|
| | control of the state-owned farm | |
| Distribution | <ul style="list-style-type: none"> - Products are split into 70:30 between the state and the production team - Production team could keep the surplus above production targets | <ul style="list-style-type: none"> - Production teams are allocated 60% of the total harvest |

The changes in agricultural sector began with instructions on June 28th in 2012. First, the government reduced the size of agricultural productions units from fifteen to between four and six people. This policy was same as Kim Jong-il's agricultural sector reform but it did not successfully expand across the country. It is widely understood that most of teams will be family-centered under this system. Second, those sub-work teams are given a plot of land for several years, while those lands are still under the control of the state-owned farms. Third, the government takes 70% of the target production and the farmers can keep 30% of the harvest and surplus of the production.

Things are very different compare to the past. In the past, North Korean farmers were forced to give the entire harvest to the state. In exchange, the state provided fixed rations and other daily necessities. But now, the farmers do not have to give everything to the state, and they can even sell or keep the surplus of the productions.

The "May 30th Measures" was even more drastic. The sub-work teams were given bigger yields from the government – 3,300 m² and they are allowed to

have 60 percent of the total harvest rather than 30 percent from 2015. This new system's effectiveness is noticeable and succeed in increasing grain production in 2015 as smaller work-team structure is more effective than larger work team according to the North Korean media.

North Korea has expanded "field management system (*Pojon tamdangje*).” The smaller sub-work teams, consisting of 2 to 3 or 3 to 4 people, are allocated a certain amount of field and they are responsible for cultivating the field. It aims at increasing the responsibility and ownership of farmers. It was originally piloted from early 2004 in Suan but was suspended and it was once again implemented at the Samjigang Cooperative Farm in Jaeryong Country, South Hwanghae Province in 2012. Only 2-3 or 3-4 people are responsible for specific field (pojon) from planting to harvest stage. And the shares of production is distributed to the farmers in accordance with the output of the production. These measures increased motivation of farmers. It was just a trial run, but showed a very favorable results that the government decided to spread this new system to other farmlands in the country.

2.2 Reform in Industrial Sector

Industrial reform in Kim Jung-un regime is very similar to Kim Jong-il's. The county implemented 'Socialist Corporate Responsible Management system.' Through this system, enterprises, factories and cooperative organizations are granted certain rights to engage in business activities autonomously. They have practical management rights over the means of production based on socialistic

ownership. The managers of the factories can decide which products to produce and can sell at their own discretion. Also they can decide how, when and where they purchase technologies, raw materials and necessities for their enterprises. Additionally, they have right to hire and fire workers and decide the wage of the workers. For example, workers were paid more than before. For example, Musan Iron Mine increased wages from 3-4,000 won per month to 300,000 won per month in September 2013.³¹

Competition charts are posted at the various locations around the factory and this has created a “Socialist Production Competition” among workers. Factories that submit detailed reports of their business performance receive gifts, and the unit which accomplished the most is rewarded with a special dinner. Moreover, factory 326 constructed residence complex for the employees and workers can receive housing after working three to four years in the factory.³² The *Choson Sinbo* reported about Pyongyang Electric Cable Factory 326 as the factory to be labeled as a ‘leading unit.’³³ Managers have rights to decide the plan and the wage of their factories. Worker’s monthly wages have risen and they earn dozens

³¹ Tudor, D., & Pearson, J, “North Korea Confidential: Private Markets, Fashion Trends, Prison Camps, Dissenters and Defectors,” (*Tuttle Publishing*, 2015), pp.23

³² “조선신보 “北, 작년 3 월 생산단위 ‘독자경영제’ 도입,” 연합뉴스. 2014.04.03, <http://www.yonhapnews.co.kr> (Access Date: 2016.5.1)

³³ “평양 3.26 전선공장에서 보는 경제관리의 새 시도,” 조선신보, 2013.04.24

of times more than the national average every month. Some of the workers' wages rose to over 100 times than the average.

These improved economic management system motivated workers' desire to work. As the overall production has increased, it can be concluded that the boost to workers' motivation is the most important part of the change in the economic change.

2.3 Open-Door Policy

The North Korean government created Special Economic Zones (SEZ) and Economic Development Zones (EDZ). Kim Jong-un established the Economic Development Zone (EDZ) law in May 2013 and designated 13 EDZs and one SEZ in November 2013. The purpose of creating SEZ and EDZ is to attract foreign capital and investment due to the poor economy.

In July 2013, the North Korean Central news Agency announced the designation of six more EDZs through the various provinces in North Korea. In 2015, Kyongwon Economic Development Zone was established. It was the 20th EDZ. A total of 21 EDZs have been set up since Kim Jung-un's first mention of EDZ at a plenary meeting of the Workers' Party central committee on March 31st, 2013. Among them, 8 of them are designated on the Yalu and Tumen Rivers near China and others are dotted around the country.

These zones are categorized in five different groups: Export processing/Trade Zone; Industrial Development Zone; Agricultural Development Zones; Tourist

Development Zones; and Economic Development Zones.³⁴ These zones were established in different regions with specialties according to region. The one that near the Chinese border is to attract foreign tourists, especially Chinese people. Since Kim Jong-un came to power, North Korea wants to attract as many tourists to the country as possible. By 2020, officials plan to lure two million people from the world.³⁵ North Korea plan to develop Onsong Island Tourism Development Zone into a tourism zone that includes a golf course, swimming pool, horse riding course, and restaurant. And they also plan to make a cultural experience space where tourists can enjoy both Chinese and North Korean culture.³⁶

These economic zones are special zones where foreign traders receive preferential treatments in accordance with the laws provided by the state. North Korea has enacted the Economic Zone Development Act on May 29th 2013. This law has 7 chapters and 62 articles. According to the law, investors' rights, interests, properties and profits are under protection by the law and the state shall not nationalize their properties.³⁷ The law stipulates that investors can lease land

³⁴ Abrahamian, A, "The ABCs of North Korea's SEZs." *US-Korea Institute at SAIS Report*, 2014, p.14

³⁵ 이재윤, 「북한, 관광산업 투자현황」, <http://www.globalwindow.org> (Access Date: 2016.5.20)

³⁶ “북한, 접경지역 관광개발 속도... “중국인 관광객 겨냥,” 연합뉴스. 2016.01.05, <http://www.yonhapnews.co.kr> (Access Date: 2015.05.20)

³⁷ 유현정, 「북한의 [경제개발구법] 에 대한 평가와 함의」, 『북한연구학회 동계학술발표논문집』, 2013(단일호), pp. 521-530

for a maximum 50 years and the income tax rate sets at 14 percent of profit. This law applies to EDZs except Rason Economic and Trade Zone, Hwanggumphyong and Wihwado economic Zones, Kaesong Industrial Zone and Mt. Kumgang Tourist Special Zone.³⁸

³⁸ 유현정. 2013. p. 521

Chapter IV. Evaluation of Economic Reform in North Korea

1. The North Korean Economic Reform's Performance and Limitation

In relative terms, new policies that were introduced in North Korean economy under Kim Jong-il and Kim Jong-un resemble those of China in the late 1970s. However, no one really knows what impact these policies have made and it is likely that the result of those economic policies will not be in the same level of economic achievements in China.

1.1 Economic Growth Rate and production

North Korea releases very few economic data that are reliable. And since the mid-1960s, the North Korean economy began to grow very slow and the North Korea government reduced reporting official figures. The major data sources on the North Korean economy in South Korea is Bank of Korea, the Ministry of Unification for intra-Korean trade and cooperation and Korea Trade Promotion Agency (KOTRA). Below table is from Bank of Korea that shows the economic growth rate of North Korea from 1995 to 2014.

Economic Growth rate of North Korea

(Increased rate compared to previous year, %)

| '95 | '00 | '01 | '02 | '05 | '06 | '07 | '08 | '09 | '10 | '11 | '12 | '13 | '14 |
|------|-----|-----|-----|-----|------|------|-----|------|------|-----|-----|-----|-----|
| -4.4 | 0.4 | 3.8 | 1.2 | 3.8 | -1.0 | -1.2 | 3.1 | -0.9 | -0.5 | 0.8 | 1.3 | 1.1 | 1.0 |

Source: Bank of Korea, 「2014 년 북한 경제성장률 추정결과」

During the 1990s, due to the collapse of Soviet Union, North Korea could not get support from socialist countries. But since 2000, the economy started to grow with the development of private economy, but it has not been stable and it has been fluctuated over years. In 2006, it shows negative economic growth again. It is because of the abnormal climate and the international sanctions against North Korean due to the nuclear tests, according to Bank of Korea.

There are different opinions on economic growth of North Korea. Some says it has relatively improved and on the other hand, even though it records plus growth over years, North Korea still suffers from economic crisis. But it is very limited to evaluate North Korea's economic reform by only looking at the economic growth.

1.2 Evaluation of Agricultural Reform

From the late 1990s to the recent years, North Korean has tried to change the agriculture sector by implementing new agricultural policies and to increase productions to escape from the economic crisis.

North Korea's agricultural reform in 2002 was to increase the agriculture production, but it is evaluated that the agriculture production could not be increased since the price increase in agricultural products did not exceed the production input costs, and the production input did not increase in the relevant sector.

After Kim Jong-un came to power, according to *Chosun Sinbo*, economic reforms motivated farmers' will to work hard. In the past, they asked the state for resources. But now they seek to find a way to increase their output by themselves. In 2015, the North Korean government celebrated and claimed success of their agricultural reform as their harvest had increased and agreed that it was because of the agricultural reform.

Production of Rice and Maize of North Korea

(Unit: 1000 tons)

| | | '02 | '05 | '08 | '09 | '10 | '11 | '12 | '13 | '14 | '15 |
|-------------------------|--------------|------|------|------|------|------|------|------|------|------|------|
| FAO | rice | 2186 | 2583 | 2862 | 2336 | 2426 | 2479 | 2681 | 2901 | 2626 | - |
| | maize | 1651 | 1630 | 1411 | 1705 | 1683 | 1857 | 2000 | 1960 | 2594 | - |
| Statistics Korea | rice | 1734 | 2024 | 1858 | 1910 | - | - | 2037 | 2101 | 2156 | 2016 |
| | maize | 1636 | 1630 | 1544 | 1301 | - | - | 1732 | 1762 | 1722 | 1645 |

*is unofficial figure

Source: FAO(<http://faostat.fao.org/>)

Statistics Korea (<http://kosis.kr/bukhan/>)

According to the table above, the North Korean's grain productions have been increasing since 2010 but it was rather weak. Herald Economy reported that North Korea's Food Production in 2014 was the greatest in the last 20 years.³⁹ North Korea claimed that it is because of the agricultural reforms. However, the production in 2015 declined again. This implies that the factors that contributed to improvement in production may be other than the agricultural reform such as favorable weather and the increase of international aid. Therefore, it is hard to conclude that increased in production in the past few years was due to the reform and hard to predict that the output of the agriculture will steadily increase. Additionally, SEP claimed that one third of North Korean children under 5 days are suffering poor growth due to the malnutrition. Through this phenomenon, it proves that a shortage of food has been lasted even though the government tried to take reform since 2002.⁴⁰

North Korean agriculture may be better than it used to be, but it is hard to say that it is because of these reforms. The data does not necessarily support a claim that reforms are happening and working in agricultural sector. It is not surprised that the North Korean government claimed that his government's policies are working as it is still totalitarian state that does not allow the opposition of the government. Moreover, as long as agriculture continues to be planned by the state,

³⁹ “북한 지난해 식량 생산량 최근 20 년 사이 최고” 헤럴드경제. 2015.02.05, <http://biz.heraldcorp.com/> (Access Date:2016.05.03)

⁴⁰ 『KDI 북한경제리뷰』 2015 년 12 월호, p.86

there will be limits to how much better it can get, no matter what reforms the state introduced.

Even though North Korean authorities reduced the number of each sub-work team members and granted autonomy within, it still adhere collective farming system. The “Field Management System” was first introduced as an experimental case in 2004, but this system did not expand to other part of the country and was suspended soon afterward. This part is very different from Chinese reform. China abolished collective agriculture and allowed “household responsibility system.” But no one receive a definite answer to what has happened and whether this system has expanded to other regions and the media does not report detailed information about this measure. And it is also possible that Kim Jong-un suddenly changes his mind and decides to stop reformist activities or reforms would face determined opposition from conservative members of bureaucracy and military.

There are many problems to be solved such as shortage of raw materials and energy. The North Korean government has not reveal the quota of the government. If the government does not consider reality and the quota for the farm is still too high, then the farmers would not have excess production. In this situation, the 7:3 distribution method cannot work. Moreover, it is possible that the government would take grain from farms in the name of military provision. In addition, with the reform policies, officials or collective farms’ executives would lose their jobs and the reform might face a strong resistance from them.

Chosun Sinbo reported that the farmers in Samjigang sold their surplus goods to the shops (*Ryanggok panmaeso*) which was owned by the state rather than markets. This shop was established in 2013 and it purchases farmers' surplus goods in similar price with the market. The chief managers of Samjigang explained why the farmers sell their grains to the government. He said that it is farmers' duty to be responsible for a national food that the farmers spontaneously gave surplus goods to the country.⁴¹

Chosun sinbo also reported about 'Patriotic Rice (*Aegookmi*)' donation campaign. A young man donated his rice to the country and other farmers started to spontaneously donate their grains to the country. Collective farms did not ask for it, but the farmers were willing to donate the crops. And as a result, the state received 300 tons of patriotic rice in 2012, 350 tons in 2013.⁴²

From long time ago, North Korea has launched a 'Patriotic Rice' campaign to feed soldiers and construction workers. They asked farmers to donate rice to the state even though many of them suffered from hunger. The intention of the government reporting about the 'Patriotic Rice' probably is to ask farmers to donate the crops again. It is also unclear that whether the 7:3 distribution system is really working. In 2012, the state took 90% of the crops from experimental

⁴¹ 양문수, 「김정은 체제 출범 이후 '우리식 경제 관리방법'의 모색: 현황과 평가」, 『나라경제』 제 16 권 제 3 호 (2014), pp. 8-9

⁴² Ibid.

region under the pretext of military provisions.⁴³ It is still very limited to get an accurate information about the distribution from North Korea, so it has not been able to grasp the exact data. It is impossible to know whether the system has expanded to national level.

1.3 Evaluation of industrial Sector's reform

The aim of reform and policies are very similar to China. The government reduced its control over state-owned enterprises and managers were granted autonomy from the state. But outcomes were different. This paper compares North Korea's industrial sector reform with Chinese industrial reform in the first and second stage, which is from 1978-1991 and evaluate its performance.

Chinese government allowed the development of private business and private enterprises while North Korean government still does not allow private activities legally. North Korean managers' authority became much stronger than before, however, their authority was just very limited and still controlled by the state.

The new management system was supposed to be implemented across the entire country in 2015. Nearly most of the industrial enterprises were expected to switch to the new model. But it did not happen. There are some industrial enterprises which operate in accordance with the new model in 2014, but such enterprises were just few and officially considered as experimental case. Most of the enterprises are still following the rules of planned economic system.

⁴³ Ibid.

The speed and depth of the policies are unclear. It is impossible to verify the impact of the measures because North Korea does not announce economic indicators as they are afraid that such data would be harmful to their country.

1.4 Evaluation of Open-door Policies

The purpose of constructing the special economic zone is to induce foreign capital and attract tourist. And SEZs are located very closed to developed countries. These are the only similarities of two countries.

Chinese SEZs have gradually expanded to other cities and to the national level. However, there is no sign to verify that SEZs and EDZs in North Korean has achieved impressive economic growth and gradually expand to other regions. So far, North Korean policies are not proceeding smoothly and effective and have not succeeded in attracting foreign capital from those designated economic development zones.

Import and Export of North Korea, 2012-2014

(US\$ million, %)

| | 2012 | 2013 | 2014 |
|-------------------------|-------------|-------------|----------------|
| Export | 2,880 | 3,128 | 3,164(↓1.7%) |
| Import | 3,931 | 4,126 | 4,446(↑7.8%) |
| Total | 6,811 | 7,345 | 7,611(↑3.6%) |
| Balance of Trade | -1,051 | -908 | -1,282(↑41.1%) |

Source: KOTRA

Foreign trade is one of the key indicators of North Korea's economy. It is not easy to get a reliable data from North Korea, so the data from South Korean Trade Investment Promotion Agency (KOTRA) is used. The total trade volume has grown by 3.6 percent over 2013 and reached 7.6 billion dollars. While the overall trade volume has increased, North Korea's exports in 2014 actually declined and the imports in 2014 exceeded its exports that the gap between export and import is 1,282 million. The trade deficit increased by 41.1%.⁴⁴

FDI Inflows in North Korea

(US\$, Millions)

| 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|-------|------|------|------|------|------|
| 37.66 | 13 | 221 | 89 | 63 | 83 |

Source: United nations Conference on Trade and Development Statistics.

World Investment Report 2016. Available at <http://unctad.org>

North Korea had established SEZ since late 1900s but the overall FDI in North Korea have fluctuated significantly during the 2000s. It implies that North Korea failed to attract FDI from outside world even though they established several economic zones.

In China, economic development was the priority to the country that the elite of the China have been consistent in carrying out policy. Not a one SEZ was closed due to the political reason. However, North Korea's SEZs are easily influenced

⁴⁴ 「2014 북한 대외무역 동향」, KOTRA

by the political factor. Two of SEZs which are KIC and Kumkang Mountain were closed down due to the conflict between South Korea.

In addition to that, the Law on Economic Development Zones has many problem that it is really hard to get an attention from foreign investors.⁴⁵ Even though the government decided to grant limited autonomy to Economic Development Zones, they are still intervened by the central government. The central government can intervene in investment and detailed plan of the regions. Moreover, the central government fear that the capital elements can spread to the whole country, so the government tries to isolate enterprises in the zone from the inner society through law.

Laws regarding investor's property rights is fuzzy. On the article 7, the state shall not nationalize or expropriate investors' properties. However, if there is an unavoidable situation that the state needs to expropriate their properties, it shall inform the investors of this in advance and make a full compensation for this. The law does not accurately specify what it means by 'unavoidable situation.'⁴⁶ It means if the government thinks there is an unavoidable situation, then the investors' properties would be taken from the state.

⁴⁵ 「경제개발구법」의 내용에 대해서는 유현정, “북한의 「경제개발구법」에 대한 평가와 전망” 『국가전략』 2014 년 제 20 권 1 호를 참고함

⁴⁶ 유현정, 「북한의 [경제개발구법] 에 대한 평가와 함의」. 『북한연구학회 동계학술발표논문』 2013(단일호), pp.528

Also North Korea is isolated from international world. The United Nations Security Council has decided to impose and strengthen sanctions on North Korea due to the nuclear and missile programs. And North Korea has shown no willingness to abandon its nuclear and this makes investment to the EDZs from major international organizations more difficult. Even China declared that it would implement a comprehensive set of sanctions against North Korea for conducting its fourth nuclear test. China represents more than 90% of North Korea's trade. If China fully implement economic sanctions against North Korea, then it would be even harder for North Korea to develop its EDZs, especially zones that are being jointly developed by Chinese companies such as Won-san, Seon-bong and Rajin. Also after the nuclear tests, many Chinese people canceled their trips to North Korea and the number of Chinese tourists to North Korea have decreased since the early 2016.⁴⁷

The SEZs and EDZs do not get much attention from foreign companies. South Korean enterprises are not interested in investing in North Korea's EDZs. Korea Federation of SMEs carried out a survey targeting 321 medium and small enterprises and conducted on survey on October 2015. 41.4% of them knows

⁴⁷ “<르포> “말썽꾸러기 이웃”... 북한행 중국인 관광객 20%로 ‘뚝’”, 연합뉴스. 2016.03.03, <http://www.yonhapnews.co.kr> (Access Date: 2016.05.20)

about EDZs and among them, only 9.3% are interested in investing in SDZs and 50.8% are not interested.⁴⁸

The North Korean government is trying to do something to recover its economy but those policies do not show distinguished accomplishments and there are still many limitations.

2. Comparison of China and North Korea

Could all the measures that were introduced under Kim era be considered as the economic reform? In other words, do the measures really represent that the North Korean government's is trying to change its socialist planned economic system into market-oriented economic system?

From the new measures that are mentioned above, it seems likely that North Korea has been trying to introduce some capitalist elements into the country. The government intended to eliminate inefficiency of economic system and created an environment that the economic actors could pursue their own profits. Some argues that these policies, such as reorganization of collective farms, granted autonomy to State-owned Enterprises and created special economic zones, looked very similar to earlier Chinese policies. Even though the economic reform policies of North Korea have similarities with those of China, the width and depth and the extent of the policy implementation process are clearly different.

⁴⁸ “북한 경제개발구에 관심있는 중소기업, 10% 미만” 연합뉴스. 2015.11.04, <http://www.yonhapnews.co.kr> (Access Date: 2016.05.20)

Ever since China started economic reform, there had been some changes within the country: 1) the change of the ownership system; 2) implementation of the market system; 3) the extent of liberalization (open-door policy); 4) decentralization of the authority. So, if those four internal factors changes, it can be concluded that North Korea is implementing comprehensive economic reform like China. Therefore, in order to evaluate how much reform has North Korea been taking, it is important to see those four internal changes in the state.

2.1 Ownership system (Privatization)

Privatization emphasizes the change in the ownership and resource allocation mechanism. China's ownership system has changed since the economic reform. The government officially allowed private enterprises in 1988. In 1989, there were 90,581 private enterprises and it increased to 2,435,282 in 2002, increased 27 times.⁴⁹ The non-state-owned economy has become a major force in the national economy. From 1992 to 1996, it was estimated that the non-state-owned economy's contribution to the total GDP was changed from 55.68% to 63.02%.⁵⁰

Ownership system has changed in North Korea as well that a certain individual can partially hold the rights of income. General trends in North Korea were that the government implicitly approved the private enterprises' activities and even though it was illegal, private economic activities were growing over time. They

⁴⁹ 조영남. 2016. p. 103

⁵⁰ Shangquan, G, *Two decades of reform in China*. Y. L. Wang (Ed.). (World Scientific: 1999), p.101

now have spread to the service sector, agriculture, fishing industry, mining and even manufacturing industries.

In the new constitution in 1998, the government reconstructed the ownership structure and expand the range of private possession. ‘Social organizations’ were added to subjects that can own the means of production. The ‘social organizations’ include politics, social, economy, religion and others. The North Korean obligatorily join a social organization. In other words, more subjects can own the means of productions compare to the past (article 20). Moreover, it strengthens the autonomy of individual economic entities.

The new Constitution does not legalize the private ownership of the means of production or private property, however, it was very significance as it did expand the subjects that can own the means of production and reduced the state ownership.

According to Yoon In Joo, the private economic activity in North Korea can be divided into three categories: the partnership contract, the name lending and private entrepreneurs.⁵¹ In the partnership contract. Individuals supply funds to state-owned enterprises and later collects the profits from those enterprises. The second is the name lending. Individuals can use their private capital to perform all economic activities under the borrowed name of the state-owned enterprises.

⁵¹ For the most informative source on the privatization in Korea, see 윤인주, 「북한의 사유화 현상 연구: 실태와 함의를 중심으로」, 『북한연구학회학보』 18 권 1 호 (2014 년), pp. 66-76

In exchange, they have to guarantee regular revenue to the state. And the last one is private entrepreneurs, such as cigarette and clothing. Vast majority of North Korean in the informal economy engage in this category.

As the state lost its functions so that it could no longer provide the proper equipment, raw materials or money to the enterprises, the role of the state was replaced by '*Donju*.' They have earned capital in the private sector and markets. They are affiliated with the government and accumulated a large amount of private capital. Donju emerged as the main goods suppliers in the markets when industrial products and imported goods are allowed to be sell in the markets.⁵² They accumulate their capital by colluding with the government institution.

New social class and new private activities have emerged, however, it is extremely difficult to obtain accurate data that can show how much privatization has progressed in North Korea. Only by interviewing North Korean defectors, it can be proved that privatization has increased over time.

How does the North Korean government respond to this new change? On the one hand, the regime tolerates it. On the other hand, it tries to control over it. In fact, the government has repeated this attitude towards these activities. In 2009, the economic inspectors received order to investigate the operations of factories

⁵² 박현일, 「북한의 신흥 자본가 ‘돈주’의 활동과 그 파장」, 『남북물류포럼 칼럼』 제 287 호

and business and to shut down private enterprises in 2009. Many businesses that were operated with private capital were shutdown.⁵³

The currency reform is another example of suppress the control over markets. As markets have been increasing, the gap between the rich and the poor has been widening due to the prevalence of markets. The rich have big refrigerators, color televisions and even luxury apartments. This kind of situation made the government feel threatened. The emergence of new class did not cause the collapse of the regime, but it can be recognized as extremely risky factor to the regime. So the government launched this currency reform to destroy the middle class and reinforce the planned economic order by absorbing resources from the private sector. The government expected that through this reform, most of the private business men would lose their capital and the government would regain the control over economy.⁵⁴ However, it only led to an inflation and a contraction of markets and the reform predictably failed. The state could not return the economy to the planned economic management structure of the past. The regime was forced to withdraw the reform and reopened the markets. However, if there is any chance in the future that the regime could offer

⁵³ Kim Suk-Jin, Yang Moon-Soo, "The Growth of the Informal Economy in North Korea." *Korea institute for National Unification*, Study Series 15-02 (2015), p. 22

⁵⁴ “北화폐개혁, 중산층 파괴위한 신보수화 조치” 연합뉴스. 2009.12.6, <http://www.yonhapnews.co.kr> (Access Date: 2016.04.30)

appropriate amount of supplies to the people and the enterprises, it would try to control the markets again.

To conclude, legally the private property ownership is not allowed and the North Korean regime firmly adhere closely to the principle of socialist economic management that the means of production is still owned by the state.⁵⁵ Those private activities still cannot be protected by laws and the North Korea society still lacks of institution that can support them. Even if the private activities could remain, it is unlikely to happen radical development of private entrepreneurs in North Korean like those of China's case without a large amount of private capital or investment.

2.2 Marketization

Through marketization, the control of the state was significantly weakened and the competition and comparative advantages were emerged in the society.

As the economic reform took in place, market's role in China has been expanding. Much of products that were controlled by the state plans were marketized. For example, in 1979, 36% of cement, 77% of steel and 85% of timber were allocated by the central plan and as of 1993, they were reduced to 4%, 20% and 10%. In addition to that, the price formation mechanism has been changed from planned price to a market price. Prices were highly-centralized

⁵⁵ “주체사상을 구현한 우리식의 경제관리법 – 노동자, 농민이 주인답게 일하는 조건을 보장,” 조선신보, 2013.12.23.

planned before the economic reform but only 58 items' price were planned, while the comparable figures for before reform was 1,336.⁵⁶ Moreover, in 1995, only 50% of the grain was allocated by the state and the other half was handled by the market.⁵⁷

The markets in North Korea have grown over time and have become an essential part of the North Korea economy since the famine of the 1990s. Markets first emerged as illegally as a response to the severe economic crisis and the breakdown of the public distribution system. But now most cities in North Korea has several of markets and North Koreans depend on the markets for their food consumption.

After the July 1st Measure in 2002, the North Korean government's attitude towards the market had changed from tolerance to utilization. They acknowledged market and allowed consumers to trade goods in markets. The consumer goods market, producer goods market and labor markets all developed over time and many people have succeeded in increasing their income and improving their living standards through markets.

⁵⁶ 정재호, 「중국의 체제개혁과 미래」, 『창작과 비평』 30(2) (2002), p.60

⁵⁷ Jae Ho Chung. "Reappearing Central-local Relations in Deng's China: Decentralization, Dilemmas of control, and Diluted Effects of Reform." in Chienmin Chao and Bruce J. Dickson (eds.), *Remaking the Chinese State: Strategies, Society, and Security* (London: Routledge). pp. 54

According to Joongang, North Korea has minimum 750 to maximum 1000 markets.⁵⁸ More items which was forbidden to be exchanged in markets, are allowed to be exchanged, and delivery service is emerged in the market that spirit of service has been gradually emerging in North Korea's society. As markets have become an important means for North Korean to secure their food, many people earn money from markets by business. Expansion of the markets rapidly weaken the planned economic system.⁵⁹

However, there were some policies to curb market before Kim Jong-un took the power. Particularly in November 2011, North Korean carried out currency reform and ordered comprehensive markets to shut down. This system created some bad reactions, such as sudden rise of price, declining of the product supply and discontent among the North Korean, that the government could not help but to withdraw the currency reform. After 2010, the government are very tolerant to the market.

The North Korean government asserts that North Korea is strictly stick to the fundamental principle of socialism. What North Korean government emphasized is to maintain planned economy and adhere to the public ownership of the means of production. North Korea does not intend to give up on planned economy and

⁵⁸ “[정치] 북한에 장마당 750 개... 애완견 용품에 손세차장도 등장,” 중앙일보. 2015.12.11, <http://joongang.joins.com> (Access Date: 2016.05.01)

⁵⁹ 이석, 김창욱, 양문수, 이석기, 김은영. 2009. 「북한 계획경제의 변화와 시장화」, 『협동연구총서』, 2009-16-03 p.95

market is just one of the means to restore its economy back to the past. So if the productivity is recovered, North Korean government claims to close the markets.⁶⁰ Recently, at the 7th Party Congress, Kim Jong-un announced five-year economic plan and gave no indication of market-style reform in economy. He even criticized China and Vietnam for taking economic reforms which implied that he has no intention to implement economic reform.

It is very hard to predict that true market economy will be implemented in North Korea, considering the regime still does not protect property rights and does not allow to conduct private business activities. North Korea has established a dual economic system composed of official and unofficial activities. Even though the government gave a limited autonomy to the managers, the official economy still dominated by state-owned companies and government agencies. It signifies that North Korea basically wants to retain its socialist system.

2.3 Open-door policies

Both China and North Korea established SEZs to attract foreign investment, foreign advanced technology and so on. Though North Korea established SEZs that China did in the early 1980s, the factors that lead to the successful economic growth in China are missing in North Korea.

⁶⁰ 임을출, 「섹션 2: 패널 7; 북한 시장화의 동학: 북한 시장화의 주요 특징과 도전 요소-북한당국의 최근 정책변화를 중심으로」. 『세계북한학 학술대회 자료집』 1(단일호) (2014), P.352

By establishing Special Economic Zones and Special Development Zones, North Korea tried to attract foreign capital, however, in view of the results so far achieve, it shows poor performance. However, it was different with China. Between 1979 and 1999, four special economic zones achieved annual growth rates 33% in Shenzhen, 24% in Zhuhai, 27% in Shantou and 19% in Xiamen.

The most significance difference of North Korea's SEZs and those of China is that success of attracting FDI. In China, with the cheap labor and preferential treatment, it successfully developed the special zones. And SEZs were allowed to have legislative authority to develop their own laws and regulations to govern the regions. These facts attracted foreign capital to flow into China. However, North Korea could not achieve what China did because of the political reasons. For example, Mt. Kumkang and KaeSung is closed because of the political conflict with South Korea.

China successfully secured foreign direct investment (FDI) reaching \$26 billion dollar in 1993.⁶¹ North Korea established its first SEZ in Rajin-Sunbong and aimed to attract \$4.7 billion, but it only secured \$58 million.⁶² With the restraint

⁶¹ Wei, S. J. . "Foreign direct investment in China: sources and consequences." *Financial Deregulation and Integration in East Asia, NBER-EASE Volume 5*. (University of Chicago Press, 1996), p. 77

⁶² 최상권, “북한의 경제특구: 현황과 과제,” 『북한학보』, 34(1), 2009. pp.179-210

against North Korea increased isolation from the world, it is getting even harder to attract FDI.⁶³

China even received fund for International Development from international organizations such as World Bank and international financial organizations. From 1979 to 1998, China received public funds approximately \$24.37 billion dollar and acquired a loan from International Bank for Reconstruction and Development (IBRD), approximately \$9.42 billion dollar.⁶⁴ On the other hand, North Korea made effort to join Asian Development Bank (ADB), but the United States, a major shareholder in the ADB and Japan rejected the North Korea's applications for admission. Therefore, North Korea have not been able to received international fund like China did.

China also received investment from its diaspora. The Chinese government tried to build a way to attract overseas' Chinese capital and tried to make a stable environment for diaspora to invest in China. On the contrary, North Korea do not have a channel to get investment from overseas and it has found itself in conflict with South Korea that it cannot get help from South Korea.

⁶³ “北 외자유치 계획 잇단 발표... 핵실험 여파로 성사 어려울 듯” 연합뉴스. 2016.01.28, <http://www.yonhapnews.co.kr> (Access Date: 2016.5.25)

⁶⁴ 최상권, 「북한경제특구의 문제분석과 대안연구」, 경기대학교 정치전문대학원 박사논문, 2010 년, pp. 188-189

The second different is separation politics from economy. The top priority of the China was economic development. But North Korea's economic policies were influenced by the political factor. For example, three of the special economic reforms that was established by Kim Jong-il are no longer operated by political reasons. North Korea's annual income from the Kaesong Industrial Complex was \$86 million in 2014.⁶⁵ A series of nuclear tests and missile tests caused increasing international sanctions on North Korea and even China and Russia participated in UN sanction. It implied that it would be even harder for North Korea to get help from two traditional economic partners because of the political reasons.

Third, China allowed local companies to enter SEZs and get other countries' technologies and knowledge. But only limited people of North Korea could enter SEZs in North Korea because of the fear that capitalist elements would flow into the society. This entry restriction is not only applied to North Korean, but also to foreigner. North Korea's restriction on international communication and entry to the SEZs are also obstacles to investment. Foreigners' belongings are inspected at borders and they cannot contact others directly.⁶⁶ In 2009, South Korean Yoo Seong-jin was held in North Korea for 137 days in charge of insulting its leaders to the North Korean who lives in the zone. Other than that, there was at least 4

⁶⁵ "N. Korea's income from tourism half of that from Kaesong complex" Yonhap. 2015.11.01. <http://english.yonhapnews.co.kr/> (Access Date: 2016.05.25)

⁶⁶ Abrahamian, A, "The ABCs of North Korea's SEZs." *US-Korea Institute at SAIS Report*, 2014, p.21

more people who were banished from the North Korean government.⁶⁷ In this situation, it is impossible to learn foreign technologies and knowledge. And a crisis situation occurs, there is a possibility that the SEZs in North Korea might shut down. Therefore, foreigners do not feel safe investing in North Korea in this situation.

2.4 Decentralization

In socialist countries, the state monopolized the control of the economic activities. While the Chinese economy under Mao was centralized, after Deng came to power, it started to change. Through decentralization, decision making power was granted from the central government to the below of the central government. Each local government started to manage their regions' personnel, investment, foreign economic policy and finance. This decentralization weakened the state planning system. The number of items that were under State Planning Commission (SPC) were reduced since 1979. For example, the number of Agricultural production that was controlled by SPC was 0 in 2000. Only 30 items of industrial production were controlled by SPC in 2000, while more than 200 items were controlled in 1978.⁶⁸ Moreover, local government has a decision making authority regarding investment.

⁶⁷ “개성공단추방 유씨 외 최소 4 건” 연합뉴스 (2009.08.26), <http://www.yonhapnews.co.kr> (Access Date: 2016.5.26)

⁶⁸ 정재호. 2002. p.58

North Korea has been decentralizing the central government's power to the local government partially since 2002. Decentralization happened mostly in industrial and agricultural fields, not in national defense and basic industries. The government raised price and wages, rationalized currency and expanded factories and enterprises' autonomy that they could dispose surplus goods by themselves. Managers were also supposed to purchase their own raw materials and they were allowed to exchange on a free market.

However, it is hard to find whether those measures are actually happening except the one that *Chosun Sinbo* reported about 326 factories. Compared to the present North Korean, China in the late 1970s and 1980s was much more decentralized. More centralized power makes the reforms more difficult.

By comparing result and implication of North Korea and China's reform, it is obvious that North Korea is not aggressive on taking reform and the leaders are not willing to initiate the economic reform. Therefore, it is too early to draw a conclusion that North Korea is transforming into market-oriented economy. Still, ownership system is very centralized and authorities of North Korean are keep arguing that if their economic situation is recovered like before 1990s, they can always go back to the planned economic system. The opening up policy looks similar to that of China in externally, but it is still much closed internally that foreign investors show no interest on investing in North Korea. In short, North Korea's economic reform policy looks very alike with China in microscopically, but on macroscopic aspect, it is hard to find North Korean government's intention to carry out a comprehensive economic reform.

Chapter V. Obstacles to Reform and Opening

Then why the outcome of the economic reform is so different? What are the factors that caused this result? What are the obstacles to North Korea's economic reform? The internal and external conditions in North Korea of the Kim Jong-Il and Kim Jong-un era differ from China in the 1980s. Therefore, though both Kim adopted similar measures that China took in the late 1970s, the circumstances that lead to the economic achievement in China are missing. There are numerous barriers hindered North Korea from carrying out comprehensive economic reforms. To achieve economic growth in North Korea, various problems should be solved in advance. Obstacles to economic reform and opening can be divided into three groups: political factors; geopolitical factors; diplomatic security factors.

Firstly, fundamental changes in the policies are restricted by political factors. The strongest factor in resisting economic reform is the desire of the Kim regime to maintain its centralized political control. This monolithic structure of the North Korea subordinates economics to politics.

One of the reasons that North Korea cannot take comprehensive reform like China is its pre-modern hereditary system. At present, Kim Jong-un represents the third generation of a heredity succession. Kim Jong-un's authority was inherited and thus his legitimacy bound to his father's legacy. So the regime does not allow any doubt or modification of its leaders' ideologies and political lines such as *Songun* – military first and *ByungJin Line* – the country's policy pursuing

the parallel goals of economic development and a development of nuclear weapon. So the leader has the ultimate decision making power.

Since the death of Kim Jong-il in late 2011, Kim Jong-un has tried to consolidate his power with purges of senior officials and by other provocative actions. The dramatic denunciation and execution in December 13 of Jan Song-taek is one of the examples that could been only seen in hereditary system.

North Korea officials believe that if the regime were to take reforms and exchange ideas with outside world, it would weaken the domestic surveillance and that is something that the elites does not want. In short, North Korea has not actively pushed for reform because of its concerns that it might damage the regime and it might hurt political stability. When China introduced reform and openness, the reform had a positive influence on their populace that the communist party was supported by the populace and very confident about what they have done. But North Korea's ruling elite seems to lack of self-confidence and they do not believe that the reform would be useful for the regime.

The shift in elite generation is very unique. The characteristics of the power elite in North Korea consist of male mostly, and in terms of age, 70s had the highest share in current regime.⁶⁹ North Korea's elite can be divided into four generations: 'Anti-Japanese revolutionary champions,'; 'soldiers of Korean People's Army and North Korean people who accomplished heroic achievements

⁶⁹ Kyo-Duk, L., Soon-Hee, L., Jeong-Ah, C., & Joung-Ho, S. "Study on the Power Elite of the Kim Jong Un Regime" *Korea institute for National Unification* (Vol. 13, No. 1). 2013, p.24

in the national liberation war.’; the third and the fourth generations are called ‘new generations.’ Still, most of the members and candidates are from the first and second generations, and the number of third generation is expected to be increased. However, no fourth generations are identified in the central committee.⁷⁰ New generation leaders are likely to be more open minded than the old ones, however, a gradual generational change does not take place in North’s power elite.

China’s elite politic is different. Mao Zedong and Deng Xiaoping had the ultimate decision making authority and they could pick and choose or remove their successors. But after Deng, China’s top leaders emerged from a selection process, not chosen by the paramount leaders. Second, there is no intense ideological battles. Third, CCP and government officials’ political retirement has become institutionalized, while during Mao’s era, purges and death were two most likely routes of political retirement. Fourth, the leaders are chosen based on their ability, not based on the historical event.⁷¹ And every 5 year, the new generation of leaders are formed. In short, elite generation shift happens in China, but not in North Korea.

⁷⁰ Kyo-Duk, L., Soon-Hee, L., Jeong-Ah, C., & Joung-Ho, S. 2013. pp.27-30

⁷¹ Zheng, S, “The New era in Chinese elite politics,” *Issues and Studies*, 41(1), 2005, pp. 192-196

Generation shift is necessary. In China, elites with reform-oriented mind actively spearhead the economic reform. And these reform-minded elite was largely formed during generational transition.

This slow shift in generation is one of the obstacles to the economic reform, as the older generations do not want to lose the privileges that they have been enjoying. And also as the top leader has the ultimate power of decision making, the leader would not make a decision which can harm him. In the process of North Korea's economic reform, the power elites need to be changed. To achieve this, the policy decision making system should be reorganized. However, the power is still highly centralized and the government is not ready with a diverse policymaking system.⁷²

Second, due to the small total territory area, there is a great possibility that the capitalist element would easily flow into the capital city of the country, Pyongyang. China used SEZs for experiment of economic reform measures. So the location of the first 4 designated SEZs were located far from Beijing. If SEZs policies had failed, Beijing would not have influenced by the failure directly. China started with 4 zones at the initial stage to experiment with market-oriented economic reforms. After being successful, the zone program was gradually spread throughout the national level in more diversified forms.

⁷² Hee-gwan, C., Kwang-seo, K., Gwang-oon, K., Keun-sik, K., Yeon-chul, K., Gee-dong, L., ... & Bo-hyuk, S. (2013). *Understanding North Korea: Indigenous Perspectives*. Lexington Books. p.104

North Korea also used experimental approach to advance economic management, like China's gradual reform process, but their territory is much smaller that this experimental approach could not work efficiently as Pyongyang can easily influenced by new economic policies. There is a possibility that Pyongyang would be affected by the economic reform policies too quickly when the policies are failed. In that case, it would be very harmful for the regime and would be much harder for North Korean government to rectify the situation.

Third, one of the biggest obstacles to reform is its hostile relationship with international world. The continuing conflict with neighbor countries has had negative impact on the North Korean economy. North Korea's expansion of nuclear arms causes tensions with the international community. The North Korea regime believes that nuclear weapons are necessary to guarantee its external and internal security. Moreover, the regime believes that nuclear weapons can be used as a mean to get an international aid. So North Korea will not trade away its nuclear weapon for economic benefits as the elite takes the missile weapon as an important equipment to preserve their authority. Also the government claimed that it would not give up on its nuclear weapons until all the other nuclear weapons states do so.⁷³ And nuclear deterrence is now enshrined in the country's constitution in 2012.

⁷³ Chanlett-Avery, E., & Rinehart, I. E. "North Korea: US Relations, Nuclear Diplomacy, and Internal Situation," *Current Politics and Economics of Northern and Western Asia*, 22(3), 341, (2013), pp.11

Chinese leaders were heavily involved in the military during the Mao, however, the Military intervention in politics had been changing into much less frequent. And China had friendly ties with the West including the U.S. and Japan to achieve economic development and secure investment, technology from outside of the world.

North Korean needs support from the world including the supply of food and daily necessities. Under Kim Jong-il era, with the help of South Korea and other countries, their GDP had increased and their life was much better than the life in the 1990s. However, their obsession with nuclear development caused the conflict with the world and it reduced their options to achieve economic recovery through international exchange at the present.

Another limitation in economic reform is lack of investment and contribution of overseas North Korean to the country. In China, overseas Chinese have invested and contributed a lot to Chinese economic reform. Overseas Chinese, including Chinese in Hong Kong, in Taiwan have played an important role in China's economic reform as they actively involved in China's economic development since the beginning of the economic reform. The location of four SEZs were closed to the places where a large number of overseas Chinese live in. It was estimated that FDI inflows by Hong Kong through 1979 to 1991 accounted

for 62% of total FDI in China and Taiwan ranked second with 9% of total FDI.⁷⁴ They were motivated by the profit incentive and patriotic emotions.⁷⁵

In North Korea, the nuclear tests led to tougher international sanctions against North Korea so it cannot get that much help from outside of the world. China is the biggest and most significant FDI provider to North Korea, but the amount of China's FDI has not been steady and consistent that it has fluctuated over years.

To achieve successful economic growth and operate SEZs successfully, the Kim regimes needs to improve relations with neighboring countries to attract more foreign capital, and bring in advanced technologies from abroad. Also the economic assistance from South Korea and the international community would be helpful for the economy in North Korea.

North Korea is not ready to change its economic system with the initial conditions that mentioned above. In this situation, any reforms would be limited unless the problems that mentioned above are changed into a favorable conditions for economic reform.

⁷⁴ Françoise, L. "FDI and the Opening Up of China's Economy," *Document de travail du CEPII*, (2000-11). pp. 24

⁷⁵ Liou, K. T, *Managing economic reforms in post-Mao China*. Greenwood Publishing Group, (1998), p.145

Chapter VI. Conclusion: Evaluation and Prospect

As a result of the economic crisis in the 1990s, the elite in North Korea wants to revive their economy through gradual change in economy. Hence, North Korea has drastically implemented economy measures since 2002.

Since the late 1970s, China introduced a system of family responsibility in agriculture, gave autonomy to private entrepreneurship and liberalized control over relations with the outside world by establishing special economic zones. With these new system, the growth of China's economy is phenomenal. In relative terms, the new economic policies that were introduced in North Korea under Kim Jong-il and Kim Jong-un regime resemble those of China in the late 1980s. And as a result of the economic crisis, spontaneous marketization and privatization are occurring in the economy. However, compare to China, North Korea's depth and length of policy change are shorter and less persistent. There is a big difference between moving toward reform and implementing comprehensive reform. North Korea needs more fundamental policy changes if it wants to achieve economic growth as China did in the 1970s. For example, dismantlement of collective farm, legalization of private economy activity and improvement of international relations.

North Korea has not actively take 'real' reform due to its concerns about political risks. Relaxation of political suppression and control is inevitable in economic reform, but it is highly likely to lead to political crisis as seen in the Soviet Union in the 1980s. The North Korea regime prefers political stability and

it will not pursue any larger scale reforms because economic reform would likely undermine the stability of the regime. In other words, North Korea's primary purpose is not economic development or economic recovery, but it is to stabilize the regime. It is true that the number of markets have been increasing, but North Korea lacks of essential elements to launch a comprehensive economic reform. Therefore, it will take some time for North Korea to start active economic reform measure.

To conclude, despite the recent economic policies introduced in North Korea over past 10 years, the prospects for the North Korean economy remain clouded due to the internal limits and absence of external cooperation. These obstacles make difficult for North Korea to reach beyond partial measures.

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Abstract (Korean)

심각한 경제위기를 벗어나기 위해 북한은 김정일 정권부터 본격적으로 제한적이지만 경제개혁을 하고자 노력하였고, 김정은 정권도 경제개혁을 이어나가려는 모습을 보이고 있다. 그 예로 김정일은 2002 년 7.1 경제관리개선조치와 경제특구를 지정하면서 점진적으로 대내경제개혁과 대외경제개방을 추진하기 시작했고, 김정은 정권은 김정일 시대의 정책을 기초하여 ‘우리식 경제관리방법’을 시작하였다.

본 논문은 2002 년부터 지금까지 진행되어온 북한의 새로운 경제정책이 무엇인지 알아보고, 정책이 어느 정도까지 진행되고 있는지를 분석하여, 북한의 개혁개방 정책이 실질적으로 착수되고 있는지 분석하는데 목적이 있다. 2002 년부터 지금까지 이루어져 온 북한의 개혁개방 정책 과정을 중국의 초기 경제개혁과 비교하여 북한 당국이 지금까지 추진하고 있는 정책이 본격적인 경제개혁인 계획경제에서부터 시장경제로의 이행인지, 아니면 국가 재정 상황이 호전되고 체제가 안정되면 또다시 계획경제로 회귀할 것인지에 대해 알아볼 것이다.

본 논문은 중국과 북한의 경제개혁을 비교하기 위해 양국의 농촌개혁, 도시개혁, 경제특구를 비교하였다. 이러한 비교분석을 통해 북한의 새로운 경제정책이 중국의 초기 개혁개방 때와 많이 유사하다는 것을 알 수 있었다. 하지만 중국의 개혁개방 초기의 정책과 비교해 보았을 때, 북한의 개혁개방은 실질적으로 착수되고 있지 않은 것으로 보이며, 북한은 탈사회주의 또는 시장경제의 도입이라는 체제개혁에서 한참

뒤져 있고, 개혁이 전면적이기 보다는 부분적인 면이 더 강한 것으로 평가된다. 그 근거로 북한 내부에 아직까지도 (1) 소유제도의 변화가 제한적이며 (2) 시장제도가 매우 제한적으로 도입되었고 (3) 국제적인 고립으로 인해 대외개방의 발전 가능성이 낮고, (4) 마지막으로 분권화 정책의 실질적인 집행 확인이 어렵다.

북한이 현재 펼치고 있는 정책은 경제발전을 위한 적극적인 정책이기 보다는, 경제 개혁으로 인해 수반되는 정치적인 불안정에 더 큰 부담을 가지고 있기 때문에 전반적인 북한의 기본적인 경제체제는 고전적 사회주의에서 조금 벗어나긴 해도 이 이상의 변화를 원하지 않는 상태에 머물러 있는 것으로 보인다. 즉, 북한의 경제정책의 근본적인 목적이 경제발전이나 경제회복이 아닌, 정권안정을 유지하기 위한 수단이라는 것이다. 내부적인 엘리트의 대대적인 변화나, 큰 사건이 있지 않는 이상 북한의 획기적인 변화를 기대하기는 어려울 것으로 보이고, 기득권층을 우선시 하고, 지속적인 핵과 미사일 개발을 시도하고 있는 점을 보면 대외개방 정책의 성공 어려울 것이다. 이렇듯 현재 여건을 보았을 때 북한의 개혁개방은 실질적으로 이루어지고 있지 않다고 평가되며, 앞으로도 어려울 것으로 전망된다.

주제어: 북한, 중국, 개혁개방, 7·1 경제관리개선조치, 우리식 경제관리방법

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